MONETARY STABILITY AND THE GOLD STANDARD.

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Our readers are aware that the Economic Consultative Committee of the League of Nations, at its meeting in May last, passed a resolution which, while recognising the great benefit to international commerce that had already resulted from stabilisation in term of gold of the currencies of most countries of the world, recalled the fears entertained by the Genoa Conference of the dangers that might arise from undue fluctuations in the purchasing power of gold. The resolution proceeded to declare that, "in view of the detrimental effects upon industry, agriculture, and the conditions of employment that would result from such fluctuations, the Committee appreciates the great interest which the central banks take in this problem, and recommends it to the attention of the Financial and Economic Organisation of the League." The Finance Committee of the League considered this question at its June meeting, and was authorised by the Council to consider "to what extent and in what way the League of Nations could most usefully assist in the study and solution of the problem of undue fluctuations of the purchasing power of gold." At the September meeting the Committee gave instructions to the Secretariat to proceed at once with the collection of information on certain specific points, and we understand that this work of compilation is now proceeding. By the courtesy of the author we are able to publish below a memorandum circulated at the June meeting of the Finance Committee by Sir Henry Strakosch to his colleagues, which served as the basis of discussion.

I.—THE ACHIEVEMENT OF EXCHANGE STABILITY.

FIVE years have elapsed since the first serious attempt was made to grapple with the chaos into which the financial and monetary affairs of so many countries had fallen as a result of the Great War. The financial reconstruction of Austria, which was inaugurated under the ægis of the League of Nations in December, 1922, was the first step in that direction. It marked the beginning of an era of real effort and achievement.

The Austrian plan of reconstruction, and every subsequent scheme of financial and monetary restoration for which the League of Nations has made itself responsible, were inspired by the fundamental conception that the attainment of an equilibrium in the economic affairs of a country is possible only if monetary stability is established, which, in turn, postulates an assured equilibrium in financial affairs. Monetary stability, in other words, was conceived to be an indispensable pre-requisite of economic restoration and, with it, of ordered social and tranquil political conditions. No severer nor more searching test could have been applied to the validity of this conception than its application to the case of Austria. It is unnecessary here to dwell on the peculiar difficulties, complexities, and uncertainties which surrounded the whole Austrian problem. They are too well known to require re-statement; but it is well to recall the apprehensions of grave political reactions which kept Europe a-quiver owing to the headlong depreciation of the Austrian currency and the economic chaos that depreciation was causing. It is also well to recall the profound impression which the singularly rapid recovery of Austria created, and the in-

TABLE "A"

AN INDEX OF THE FLUCTUATIONS OF EUROPEAN EXCHANGES.

Country.	Population Weight.	1922. Average per Cent.	1922. Fluctuation per Month.	1923. Average per Cent	1923. Fluctuation per Month.	1924. Average per Cent.	1924. Fluctuation per Month.	1925. Average per Cent.	1925. Fluctuation per Month.	1926. Average per Cent.	1926. Fluctuation per Month.	1927. Average per Cent.	1927. Fluctuation per Month.
		Actual.	Actual × Wght.	Actual.	Actual × Wght.	Actual.	Actual × Wght.	Actual	Actual × Wght.	Actual.	Actual × Wght.	Actual.	Actual × Wght.
	%	%	%	%	%	%	%	%	%	%	%	%	%
Austria	1·9	34·9	66·3	..	..	..	..	..	..	..	..	..	..
Belgium	9·2	4·3	9·5	6·2	13·6	5·7	12·5	1·2	2·6	7·5	16·5	0·1	0·2
Bulgaria	1·4	2·8	3·9	10·9	15·3	0·7	1·0	0·2	0·3	0·5	0·7	0·1	0·1
Czecho	4·2	7·8	32·8	1·2	5·0	0·4	1·7	0·1	0·4	..	..	..	..
Denmark	1·0	1·9	1·9	1·8	1·8	1·6	1·6	2·0	2·0	0·6	0·6	0·1	0·1
Esthonia	0·4	1·2	0·5	1·2	0·5	2·4	1·0	..	..	..	..	..	..
Finland	1·9	4·0	4·0	1·8	1·8	0·3	0·3	..	..	..	..	..	..
France	11·5	5·1	58·6	5·3	61·0	5·7	65·6	3·3	38·0	7·5	86·2	0·2	2·3
Germany	17·6	41·5	726·0	13,600·0	237,600·0	1·1	19·4	..	..	0·1	0·2	0·1	0·2
Greece	1·8	14·1	25·4	17·5	31·5	4·4	7·9	5·5	9·9	3·7	6·7	1·0	1·8
Hungary	2·4	14·1	33·8	20·6	49·2	15·2	36·5	0·2	0·5	..	..	0·1	0·2
Italy	11·4	5·4	61·6	2·1	23·9	1·6	18·2	2·2	25·1	4·3	49·0	2·6	29·6
Netherlands	2·1	0·7	1·5	0·6	1·3	1·0	2·1	..	..	..	..	0·1	0·2
Norway	0·8	3·9	3·1	2·8	2·2	2·2	1·8	2·9	2·3	2·4	1·9	0·5	0·4
Poland	3·3	21·0	174·3	73·4	609·2	1·5	12·4	3·4	28·2	4·9	40·7	3·8	31·5
Portugal	1·3	9·0	18·2	5·1	9·2	5·5	9·9	0·6	1·1	0·2	0·4	0·5	0·9
Roumania	4·3	9·0	43·2	3·8	18·2	4·5	21·6	3·5	16·8	5·3	25·4	1·9	9·1
Spain	6·3	1·9	6·3	1·8	11·3	1·7	10·7	0·5	3·1	1·8	11·3	1·8	11·3
Sweden	1·7	0·9	1·6	0·3	0·5	0·2	0·3	0·2	0·3	0·1	0·2	0·2	0·3
Switzerland	1·1	0·8	0·9	1·2	1·3	1·1	1·3	0·2	0·2	0·1	0·1	0·1	0·1
United Kingdom	12·7	0·9	11·4	0·9	11·4	1·3	16·5	0·2	2·5	0·1	1·2	0·1	1·3
Jugo-Slavia	3·6	10·5	37·8	3·7	13·3	3·7	13·3	1·2	4·3	0·1	0·4	..	..
Total	100·0	194·6	1,321·4	13,692·2	238,481·6	61·8	255·6	27·4	137·4	39·2	241·5	13·3	89·6
Average	..	8·6	13·2	621·0	2,384·8	2·8	2·6	1·2	1·4	1·8	2·4	0·6	0·9
				Excluding Germany.						Excl. France & Belgium.			
				169·2	821·6					24·2	138·8		
				7·7	10·7					1·2	1·6		

fluence which it undoubtedly exercised on the policies of other countries towards financial and monetary reconstruction. It may truly be said that the League's action in Austria, followed, as it was, by its hardly less remarkably successful intervention in Hungary, has blazed the trail of general monetary and financial restoration in Europe and elsewhere. Indeed, the League's plans as applied to Austria and Hungary have been made the model upon which all subsequent plans of financial and monetary restoration—whether fathered by the League or undertaken without its co-operation—have been built up. These plans, without exception, involved the linking of currencies to gold, or, in other words, the establishment of the gold standard in one form or another.

The time seems ripe for a survey to be made of the progress that has been achieved during these five years; to measure that progress in terms of monetary stability and in terms of economic advancement; and finally to consider what remains to be accomplished in the domain of monetary organisation to insure that no monetary factor shall impede economic progress.

A convenient way of measuring the progress made in monetary stability is to reduce to index numbers the currency fluctuations in relation to the dollar (*i.e.*, gold) during the five years under review. This is attempted in the subjoined Table "A," which has been constructed by working out the average percentage variations in the United States dollar value of the currencies of each country from month to month. By adding up these variations irrespective of whether they were in the direction of depreciation or appreciation, by striking an average for each year, and by weighting the individual index numbers so arrived at on the basis of population, a combined index number is obtained for the countries chosen. This method of calculation has been applied in the subjoined table to all the European countries except Russia, Turkey-in-Europe, Iceland, Albania, the Saar, Danzig, and Luxembourg. The absence of adequate statistical material was responsible for these omissions.

The table at foot of page 1 shows that the purchasing power in terms of gold of the currencies handled by the populations of the countries under review fluctuated on an average from one month to the next to the extent of :—

13·2	%	in the	year	1922
2,384·8	%	"	"	1923
2·6	%	"	"	1924
1·4	%	"	"	1925
2·4	%	"	"	1926 and
0·9	%	"	"	1927

The extraordinarily high average fluctuations in 1923 were, of course, due to the complete collapse of the German currency in that year, while the relatively high average for 1926 was caused by the wide fluctuations of the French and Belgian currencies. If these figures were eliminated from the calculation, the end average figures would be the following :—

1922.	1923.	1924.	1925.	1926.	1927.
13·2% ..	10·7% ..	2·6% ..	1.4% ..	1·6% ..	0·9%

It will be seen that progress during 1923 was slow, that with the inauguration of the Dawes Plan in 1924 it became very marked, and that the remaining period was one of steady progress, except for the retardation in 1926, to which reference is made above. The average fluctuations of 1927 are, as will be seen, the lowest of the period.

Let us see now how the countries under review have fared economically during the same period. Reliable statistical material of the volume of their production being sadly lacking, a rough-and-ready measure may be found in their foreign trade figures. The subjoined Table "B" has been constructed by adding together the annual official figures for imports and exports of each country and converting the totals into U.S. dollars by applying the average dollar value of the respective currencies for the respective years. The totals are then corrected for variations in the general level of gold prices (as measured by the index of wholesale prices of commodities prepared by the U.S. Bureau of Labour) and the results reduced to index numbers for each year :—

TABLE B.

EUROPEAN MERCHANDISE EXPORTS and IMPORTS.
(In Millions of U.S. Dollars.)

	1922.	1923.	1924.	1925.	1926.	1927.
Austria	579	617	763	663	621	706
Belgium	1,184	1,193	1,459	1,535	1,429	1,547
Bulgaria	58	76	76	95	85	93
Czechoslovakia	736	670	970	1,078	978	1,127
Denmark	551	606	702	785	766	801
Esthonia	25	35	33	42	42	54
Finland	183	242	243	280	285	318
France	3,748	3,867	4,256	4,259	3,867	4,941
Germany	2,423	2,920	3,724	5,056	4,725	5,792
Greece	181	147	203	222	180	241
Hungary	176	154	259	292	369	342
Italy	1,191	1,302	1,470	1,690	1,733	1,853
Netherlands	1,256	1,293	1,540	1,713	1,685	1,786
Norway	360	356	357	432	420	439
Poland	289	446	529	591	926	611
Portugal	117	123	133	168	157	160
Roumania	184	218	270	286	333	435
Spain	625	645	630	651	561	704
Sweden	596	647	713	752	793	855
Switzerland	682	711	816	871	820	883
United Kingdom	7,162	8,009	8,574	9,352	8,608	8,774
Yugo-Slavia	137	175	228	301	273	291
	22,443	24,452	27,948	31,014	29,656	32,043
U.S. Wholesale Price Index (Bureau of Labour, 1922=100	100	103·3	100·6	106·7	101·6	99·6
Merchandise corrected to U.S. prices (1922=100)	22,443	23,671	27,781	29,067	29,218	32,500
Index No.	100	105·5	123·8	129·5	130·2	144·8

* These figures are estimated, as the official returns are not yet available.

† Estimate based on the returns for the first ten months of 1927.

‡ Estimate based on the returns for the first six months of 1927.

The progress shown is handsome, and particularly impressive when the figures are examined in the light of the currency fluctuation indices of Table "A." For easier comparison they are here set one below the other :—

	1922.	1923.	1924.	1925.	1926.	1927.
Foreign trade index	100	105·6	123·8	129·5	130·2	144·8
Currency fluctuations index	13·2	10·7	2·6	1·4	1·6	0·9

The close coincidence of increasing economic progress (as expressed in the foreign trade index) with every improvement in the stability of currencies is striking. Thus the modest progress made in the latter direction in 1923 (if Germany is excluded) is reflected by a modest improvement of the trade figures, the substantial progress in monetary stability in 1924 by a substantial improvement in the trade of that year, and, finally, the progress in the remaining three years, checked by virtually stationary conditions in 1926 (if France and Belgium are excluded) by a very similar development in the trade figures.

II.—GOLD BECOMES THE GENERAL STANDARD.

The monetary standard chosen by all the countries of Europe that have stabilised their currencies during the last five years is the gold standard in its various forms. Some of them have adopted the "gold specie standard," which involves the obligation to exchange the local currency on demand for gold coin; others have elected to establish the "gold bullion standard," involving the obligation to exchange it into gold bullion; and others, again, the "gold exchange standard," which makes the local currency exchangeable into foreign gold exchange. And there is, finally, a numerous intermediate class of countries in which the local currencies are convertible at the option of the currency authority into either gold or gold exchange, or in which convertibility into gold exchange is intended to be merely a transitional stage towards the ultimate establishment of the gold specie standard.

Looking beyond Europe, we find that the trend of development in monetary organisation has proceeded on very similar lines to that of Europe. An attempt is made in the subjoined Table "C" to group the European and

a number of extra-European countries according to their monetary standards. The classification is of necessity an uncertain one so far as concerns those of the countries which fall within the intermediate class to which reference has been made. They have been included among the gold exchange standard countries because they are all at present operating their monetary machine as if they were on that standard. It will depend upon their future policy whether they will continue to do this, or whether they will ultimately elect to adopt one or other of the other types of gold standard. Their legislation is wide enough to permit them to do so.

TABLE "C."

POSITION OF FOREIGN CURRENCIES AND CONVERTIBILITY OF NOTE ISSUES.

(Since the date on which this memorandum was written, Bulgaria, France, and Greece have been transferred from the *de facto* to the *de jure* section of the table.)

	De Jure Stable Currencies.										De Facto Stable Currencies.		Others.		Total.
	Gold Exchange Standard.			Gold (Specie) Standard.				Gold Bullion Standard.		Quasi Bimetallic.					
		Convertibility not yet legally in force or suspended.			Convertibility not yet legally in force or suspended.										
	Population millions.		Pop'lation millions.	Population millions.		Pop'lation millions.		Pop'lation millions.		Pop'lation millions.		Pop'lation millions.	Population millions.		
EUROPE	AN COUNTRIES—			Latvia.. 1·8		Austria. 6·8		Denmark. 3·6		Belgium(4) 7·8	Bulgaria. 5·1		Portugal .. 6·1		
Albania	1·0	Germany	63·6	Sweden 6·1		Czecho-slovakia 14·6		Great Britain 49·7		Switzerland(5) 3·9	France 41·4		Roumania 17·6		
Belgium	7·9			Norway 2·9		Hungary 8·6					Greece (6) 6·7		Spain .. 22·6		
Danzig	0·4										Yugoslavia 13·1				
Esthonia (1)	1·1														
Finland	3·6														
Italy ..	43·0														
Lithuania..	2·2														
Poland (2) ..	30·2														
Total	89·2=24·1%	..	63·6=17·2%	..	10·6=2·9%	..	30·0=8·1%	..	53·3=14·3%	..	11·6=3·1%	..	69·3=17·9%	..	40·5=13·5%	370·0=100 %
EXTRA-EUROPEAN	COUNTRIES—			Argentine.. 10·6		Egypt.. 14·5				Java (4) 55·0			Japan (7) 60·9		
Chili ..	4·0	Peru ..	5·5	Australia .. 6·2		N. Zealand . 1·4							Mexico. 15·0		..
Colombia ..	7·1			Brazil . 35·2		Uruguay.. 1·8									
Dominican Rep.	0·9			Canada. 9·7											
Guatemala .	2·5			S.Africa 7·6											
India(3)	320·0			U.S.A.. 120·0											
Siam ..	10·1														
Total ..	354·8=51·0%	..	5·5=0·8%	..	187·3=26·9%	..	17·7=2·5%	..	..	..	55·0=7·9%	..	..	..	75·9=10·9%	696·2=100%
Grand Total	444·0=41·6%	..	69·1=6·5%	..	198·1=18·6%	..	47·7=4·5%	..	53·3=4·9%	..	66·5=6·2%	..	66·3=6·2%	..	122·2=11·5%	1,066·2=100%

NOTES.—(1) Sterling exchange standard. (2) At present gold exchange, but eventually gold (specie) standard. (3) Transitional until passing of Reserve Bank Bill, which proposes gold bullion standard. (4) Legally can pay notes in silver. In practice export of gold allowed where reciprocity exists. (5) Really "Cours forcé," but nominally may give silver for notes. In practice gives gold if required. (6) New Statutes contemplate gold exchange standard. (7) Though convertibility has never been suspended, there is an embargo on the export of gold, and the yen has been subject to continued, though moderate, fluctuations for several years. The population figures are for the year 1927 (estimated).

The most striking feature of the compilation is not so much what emerges from the grouping of countries under the various classes of standards adopted, but the fact:—

(*a*) That more than half the population of the world (*i.e.*, about 944,000,000) is to-day handling money which is either *de jure* or *de facto* linked to gold, and

(*b*) That of the 1,066,000,000 people inhabiting the countries under review, only 122,000,000, or 11½ per cent., are to-day living in conditions of monetary instability, and these, it should be added, are all struggling towards the re-establishment of their currencies on a gold basis.

The achievement is a remarkable one, especially if we reflect that real progress only began to be made four years ago and that monetary stabilisation involved, as a condition precedent to it, the settlement of numerous financial questions of a most troublesome kind. It meant the funding of a vast amount of short-term indebtedness and the settlement of unwieldy international debts on lines that limit the current interest and redemption payments within manageable proportions, and it involved, of course, acceptance by the countries concerned of a rigid financial régime.

Equally remarkable—though perhaps not surprising—is the unanimity with which practically the whole of the civilised world has elected to adopt gold as its standard of value. This development is the result not of any international convention or other international action, but of the individual choice independently made by each of the countries concerned. It is true that the international conferences at Brussels and at Genoa had advocated the general adoption of the gold standard; but the resolutions passed by these conferences were binding on none of the countries participating in them. They were perfectly free to adopt whatever monetary standard seemed to them best. We must conclude from their action that they all regard the gold standard as the most appropriate to the present and foreseeable future circumstances; that they consider convertibility of local currencies into fixed weights of gold, or their equivalent in other gold standard currencies, to be the surest safeguard in the present state of our civilisation for the limitation of the monetary circulations to the legitimate needs of exchange; and that they regard fixity of the exchanges, which this convertibility assures, as indispensable in a world which depends for its prosperity and progress on international trade in an ever-increasing measure. Finally, we must conclude from their action that they are content to link the purchasing power of their money to what gold will buy—that is, to tie their general price levels to gold (and through gold to the price levels of all the other gold standard countries)—in a word, to join in a great monetary partnership with gold as their common bond.

They are content, metaphorically speaking, to tie their currency and price-level ships to a common buoy—gold. The huge ocean-going ship of the U.S.A., towering over the many smaller craft of the other nations, lies there side by side with them, all made fast to their common buoy. A sea captain in real life would feel ill at ease if he found that he had moored his ship to a buoy that was anchored to nothing, and was free to drift wherever the currents and the winds or the manœuvring of the other

ships made fast to it might take it. He is not likely to be satisfied with the assurance of the port captain that, in spite of its not being securely anchored, the buoy had drifted but slightly during the last half-century before the war, and that a material change of its position had only taken place as a result of the exceptional circumstances which the war had created.

Have the captains of our metaphorical currency ships less reason to feel uneasy? Is the buoy to which their ships are moored firmly anchored to prevent it from drifting? Assuredly not. There is nothing in the construction of our metaphorical "gold buoy" to prevent it from yielding to the currents of supply and demand, and from drifting to wherever these may take it, and dragging with it the ships that are made fast to it. True enough, our currency ships are all equipped with machinery appropriate to their size (the central banks), which has been installed with the primary object of enabling their captains to manœuvre them to and fro so as to keep them at their proper stations in relation to the buoy, and so to the other ships. But if that machinery is employed merely to perform this primary object, they are in no safer condition than the ships in real life that are tied to an unanchored buoy. On the other hand, if their captains agree to closely co-operate in applying the machinery at their command to manœuvring their ships with a view to keeping the buoy in a pre-determined and safe position, they will have ceased to be at the mercy of the elements. Leaving the metaphor, these undoubtedly were the considerations which inspired the resolutions of the Genoa Conference when it recommended that the central banks of gold standard countries should co-ordinate their credit policies with a view to maintaining stable the purchasing power of gold.

III.—EFFECT OF FLUCTUATIONS IN VALUE OF GOLD.

To appreciate the urgency of concerted action of this kind, let us examine somewhat closely into the reactions that the instability of our standard of value is likely to call forth. We all know that, in our complex economic organisation of to-day, the vast majority of transactions into which money enters are not settled the moment they are concluded, but that they usually involve contracts the settlement of which is deferred over widely varying periods, and that it is this fact which causes changes in our standard of value to affect differently different classes of the community—that, in other words, such changes cause a redistribution of wealth. We have learned from the monetary history of the last five years how destructive to economic progress—nay, to economic life itself—is the redistribution of wealth which the violent bouts of currency depreciation and appreciation have occasioned; but we are, perhaps, inclined to ignore, or at any rate to underrate, the repercussions that are produced by relatively minor changes in the purchasing power of money—*i.e.*—in a gold standard world—of gold.

An attempt is made in the succeeding pages to analyse these repercussions. For this purpose a "National Income and Distribution Account" has been compiled, which, though based on British figures, is probably representative of the conditions of the great majority of the countries with which we are particularly concerned. The figures from which this account has been built up were compiled for the writer by Mr Joseph Kitchin, and are, in the main, based on figures contained in the publication by Professor Bowley and Sir Josiah Stamp, entitled "National Income, 1924" (published in 1927). They do not pretend to represent statistical facts (and the authors of the publication mentioned must not be held responsible for the allocations made), but they are put forward as the best estimate that the available data permit to be made. They are, however, believed to be sufficiently near the truth to serve the present purpose:—

TABLE "D."

NATIONAL INCOME and DISTRIBUTION ACCOUNT.
Prices = 100.

Income. Money Value £ Millions.		Distribution. Money Value £ Millions.	Distribution. % of Total Income.
4,060	(a) Public debt service	405	10·0
	(b) Interest and rent	668	16·4
	Fixed money obligations	1,070	26·4
	(1) Other governmental exp'nditure	285	7·0
	(2) Profits of Enterprise	685	16·8
	(3) Wages and salaries	2,020	49·8
	Residue	2,990	73·6
4,060		4,060	100·0

The distribution of the national income has been split up, it will be observed, into the constituents of (*a*) Public Debt Service and (*b*) Interest and Rent, which are grouped together under the main heading of "Fixed Money Obligations"; and (1) Other Governmental Expenditure, (2) Profits of Enterprise, and (3) Wages and Salaries, grouped under the main heading of "Residue." The first group, as the heading implies, comprises the obligations in respect of contracts involving fixed money payments. It includes, apart from interest and redemption charges on the National Debt, the debts of public bodies and private undertakings, also rent on landed and house property and pensions. These obligations may be said to constitute a first charge on the national income. They have to be met whatever the income may be, if default is to be avoided. The second group, headed "Residue," represents the balance of the national income that is available to meet (*a*) Governmental Expenditure other than debt charges; (*b*) Profits of Enterprise (which includes all dividends of a variable type, such as accrue to holders of ordinary or deferred shares of companies); and, finally, (*c*) Wages and Salaries. It is this "Residue" that, on the one hand, has to bear the burden of any deficiency of production and/or an increase in the purchasing power of gold (a fall of the general level of gold prices), and that, on the other, reaps the benefit of an increase of production and/or a decrease in the purchasing power of gold (a rise of the general level of gold prices).

Let us now reconstruct the national income and distribution account on the assumption that the national production remains the same, but that its money value has increased by 20 per cent.—that is, that general prices have risen 20 per cent.:—

TABLE "E."

NATIONAL INCOME and DISTRIBUTION ACCOUNT.
Prices = 120.

Income. Money Value £ Millions.		Distribution. Money Value £ Millions.	Distribution. % of Total Income.
4,872	(a) Public debt service	405	8·3
	(b) Interest and rent	665	13·6
	Fixed money obligations	1,070	21·9
	(1) Other governmental exp'nditure	362	7·4
	(2) Profits of enterprise	871	17·9
	(3) Wages and salaries	2,569	52·8
	Residue	3,802	78·1
4,872		4,872	100·0

We can see at a glance that this rise of general prices reduces the proportion of the national income which falls to those possessing fixed money claims from 26.4 per cent.

to 21.9 per cent., and so makes available for purposes of the "residue" an increased proportion of a like difference. It reduces, in other words, fixed money claims by 17 per cent. and increases the residue by 6 per cent. This increase has been apportioned among the various constituents of the residue proportionately to their distribution in the first account (Table "D"). But that, of course, is not what happens while prices are on the upgrade. The redistribution involves a difficult process of gradual adjustments under considerable friction. The first to benefit, of course, are those interested in "profits of enterprise," but pressure from the wage-earners, whose real wages have been diminished by the rise of prices, soon develops. Wages are increased sometimes by amicable settlements, but more often following strikes.

A rise in prices, or, indeed, the mere expectation of a rise, stimulates enterprise, and so creates a greater demand for capital goods, while the greater share of the national income in the hands of the wage-earners is freely exercised, mainly for the purchase of consumable goods. Both accentuate the rise of prices and call for an increasing volume of money and credit to effect the exchange of the more rapidly circulating goods. When the monetary circulation and the credit structure have reached the limit to which the central banks feel justified to expand them (having regard, on the one hand, to legal reserve requirements and habit or custom, and, on the other, to the size of available gold reserves), and when the prospect of a further rise of prices consequently vanishes, enterprise is curtailed and the reaction sets in. The pendulum takes its downward course.

Finally, let us examine the national income and distribution account, on the assumption that the national production remains unaltered, but that general prices have fallen 20 per cent. :—

TABLE "F."

NATIONAL INCOME AND DISTRIBUTION ACCOUNT.

Prices = 80.

Income.		Distribution.	
Money Value £ Millions.		Money Value £ Millions.	% of Total Income.
3,248	(a) Public debt service	405	12·5
	(b) Interest and rent	665	20·5
	Fixed money obligations....	1,070	33·0
	(1) Other Governm'tal expenditure	208	6·4
	(2) Profits of enterprise	499	15·4
	(3) Wages and salaries	1,471	45·2
	Residue	2,178	67·0
3,248		3,248	100·0

The proportion of the national income which falls to those having fixed money claims rises from 26.4 per cent. to 33 per cent.—*i.e.*, by 25 per cent. The burden of this is borne by the "residue," which is decreased by 9 per cent. "Profits of Enterprise" suffer first, because a reduction of money wages, in spite of their greater purchasing power, is stoutly resisted. Diminishing profits and the expectation of receding prices damps down enterprise; wages are gradually depressed. The friction and heat engendered in the process is probably even greater than in the case of upward adjustments of wages as a result of rising prices. But if an equilibrium in the distribution of the burden that falls on the "residue"—is finally to be re-established—that is, if it is so to be distributed among its constituents as to re-establish the original proportions of their shares in the "residue"—what does this involve?

The share of the national income falling to the wage-

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BY

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earning and salaried class would require to be reduced from £2,020,000,000 to £1,471,000,000—that is, by £549,000,000, or 27 per cent.—while prices will have fallen by only 20 per cent., thus implying a debasement of the standard of living of nearly 9 per cent. (the ratio being 80 per cent. to 73 per cent.). The other constituents of the "residue" would, of course, have to suffer in like proportions. If, for social or political reasons, it proved impossible to debase the standard of living of the wage-earning class to the full extent appropriate to the situation, the deficiency could in practice only fall on "profits of enterprise." But it is evident that the additional burden these profits could bear would be relatively insignificant, and that if they were called upon to do so, and the reward of enterprise were thus reduced to inadequate proportions, the incentive to undertake the risks involved in it would be destroyed and enterprise curtailed. Serious unemployment would be the result.

A fall in prices, or the expectation that the trend will be downward, causes enterprise to be damped down. The demand for capital goods slackens, and the lesser share of the national income in the hands of the wage-earning class reduces its power to acquire consumable goods. The increased share falling to the Rentier class, on the other hand, is very sparingly exercised in the purchase of consumable goods, and only very gradually and rather fitfully in the purchase of capital goods (the latter very largely depending on the spirit of enterprise reviving). These factors all combine to accentuate the fall of prices, to lessen the amount of money and credit needed for the exchange of the sluggishly circulating goods, and so to increase the amount of available credit. The pendulum thus reaches the lowest point in its downward course only to be driven upwards by the impetus to enterprise which the plethora of available credit engenders.

For easier comparison the distribution of the national income shown in Tables D, E, and F are here tabulated together:—

TABLE "G."

EFFECT OF VARIATIONS OF PRICES ON VARIOUS CLASSES OF NATIONAL INCOME.

(In Millions of Pounds.)

Level of Prices.	Total National Income.	Fixed Money Obligations.						Residue.							
		Public Debt, Service, and Pensions.		Interest and Rent.		Total.		Other Government Expenditure.		Profits of Enterprise.		Wages and Salaried.		Total.	
	£	£	%	£	%	£	%	£	%	£	%	£	%	£	%
120.....	4,372	405	9·3	665	15·6	1,070	24·9	363	7·4	871	17·9	2,569	52·8	3,803	87·1
100.....	4,020	405	10·0	665	16·4	1,070	26·4	295	7·0	685	16·3	2,020	49·3	2,950	73·6
80.....	3,548	405	13·5	665	20·5	1,070	33·0	203	6·4	499	15·4	1,471	45·2	2,178	67·0

NOTE.—In this and the preceding two tables it is assumed for simplicity's sake that the National Income is equivalent to national production, and therefore wholly subject to changes in the level of prices. This is not the case, strictly speaking, though the difference (which is due to duplication in the National Income figures), is relatively small.

It is almost unnecessary to say that, in a world in which the currencies and prices of the great producing countries are linked to gold, and through gold one to the other, these cyclic movements of prices must have their immediate repercussions over the whole area of gold standard countries—that they are, in fact, cyclic movements in the purchasing power of gold. Nor can there be any doubt that these ups and downs in the purchasing power of gold, with all the dislocations which they engender, are a serious hindrance to economic progress and a source of almost incessant social and political friction.

IV.—GOLD, CREDIT, AND PRODUCTION.

The conviction is gaining ground that, by co-ordinating the credit policies of gold standard countries, it is possible, if not to obviate, at any rate very largely to mitigate, these cyclic movements. If the force of the original impulse which sets the pendulum in motion were curbed, its momentum would be lessened and, with it, the amplitude of the arc it describes.

When analysing, in the previous chapter, the effect of a rise and of a fall in the general level of gold prices, we have assumed that the national production remains unaltered. Opinions differ as to whether the stimulus of rising prices causes production to be increased to any material extent, and the depressing effect of falling prices to reduce it, though it is more generally believed that this is the case to some extent; but there can be no difference of opinion regarding the general trend of production. This, it is certain, is steadily increasing, and it would be found on examination that the rate of increase is accentuated in times of rising prices and somewhat retarded in times of falling prices. The advance in population alone necessitates a growing volume of production if the standard of living is to be maintained. Besides, it is in human nature not to be content to accept as permanent the standard of life that has been attained, but ever to strive towards improving it. This natural increase of production, which may be termed economic progress, has been measured by Professor Cassel over an extended period. He reaches the conclusion that it proceeds at the rate of 3 per cent. per annum. Mr Joseph Kitchin, examining the question from a somewhat different angle, arrives at a very similar result.

It is very clear than any increase in production involves a corresponding increase in the volume of exchange of goods and services, and, other things being equal, calls for a corresponding increase in the volume of currency and credit to effect this exchange. In a gold standard world it calls for a broadening of the base upon which currency and credit are built, that is, a corresponding increase of monetary gold reserves. The augmentation of these depends upon the amount of gold that the world produces every year in excess of what it chooses to employ in the industrial arts or for purposes other than money. If the annual addition to these gold reserves is too great relatively to economic progress, the effect is to raise—and, if it is too small, to reduce—the general level of gold prices, or, in other words, to depreciate or appreciate respectively the purchasing power of gold. Our gold standard world thus depends for the stability of its general price level on two factors that may be said to be entirely fortuitous—the amount of fresh gold currently produced and the extent to which gold is used for purposes other than money.

Professor Cassel was one of the first prominently to emphasise these considerations, to draw attention to the inadequacy of the current additions to the monetary gold reserves, and to insist upon the urgency of international co-operation, with a view to economising the use of gold and thus to save the world from a steadily receding price level and all that this implies. The Genoa Conference, without pronouncing on the adequacy or inadequacy of the probable future supply of monetary gold, recommended the universal adoption of the gold, exchange standard, co-operation of central banks, and co-ordination of their credit policies, with the object of maintaining stable the purchasing power of gold. Latterly, the question came under the consideration of the Royal Commission on Indian Currency and Finance. In the course of

his evidence before the Commission, Mr Joseph Kitchin—a recognised authority on precious metal statistics—submitted exhaustive figures which amply confirm Professor Cassel's conclusions.

It is sometimes suggested that a rise in the value of gold (that is, a fall in prices) is likely so to stimulate the gold-mining industry as to substantially increase its output. For technical reasons alone, it is extremely unlikely that anything but a very pronounced fall in prices would have this effect, even if the whole benefit of such a fall were to accrue to the gold-mining industry. It is on this latter point that the suggestion breaks down completely. We have seen that the redistribution of the national income occasioned by a fall in prices throws the resulting burden on "Governmental Expenditure," "Profits of Enterprise," and "Wages and Salaries," that the burden is greater relatively than the fall of prices, and that, pending the reduction of real wages, it has to be borne by the remaining components of the residue. Taxation has to be increased and "Profits of Enterprise" reduced. Is it reasonable to suppose that any legislative body will hesitate to put the major part of that burden—if not the whole of it—on the industry that can obviously bear it best, when all others are groaning and struggling merely to keep alive? Is it reasonable to suppose that the mine-worker will submit to so drastic a reduction of his wages as will debase his standard of living rather substantially below the level he was accustomed to enjoy, when the industry he is serving prospers? Neither of these propositions would seem to require more than a moment's reflection to be answered in the negative. Whatever the advantage that may theoretically accrue to the gold-mining industry, it is bound in practice to be largely swallowed up by the additional burden which will inevitably fall on it.

Forecasts, however carefully compiled, are obviously liable to error, and there are many who—perhaps not unnaturally—shrink from leaning on them, however lightly, as a guide for the framing of future policies. But, whatever faith or doubt we may have in regard to the forecasts of the future gold production, there can be no disagreement on the point that, looking into a reasonably distant future, the supply of gold for monetary purposes cannot be gauged with any certainty, and that it is beyond our power to control it. Indeed, it would postulate a wholly improbable conjunction of circumstances for it to correspond always precisely to the needs of the economic progress which the world is and will be making; this, of course on the supposition that gold standard countries adhere rigidly to their present practices in the matter of gold reserves.

But the problem is not limited to the question of the future supply of monetary gold in its relation to the world's economic progress. We all know that the distribution of the monetary gold reserves of the world at present available is a very uneven one, that some countries—chief among them the United States of America—hold relatively abundant gold reserves, while others, especially those who have more recently returned to the gold standard, are pursuing a policy of not only holding on tenaciously to what they have, but of also trying to augment their reserves. They are—to return to our metaphor—manœuvring their ships so as to get nearer the gold buoy. The combined effort in the same direction of the many small craft causes the gold buoy to be dragged away from its original position, and with it the other ships that are moored to it. It is pretty evident that a policy of keeping a tight hand on credit, if only with the object of maintaining gold reserves and attracting just a little more, will react on the general level of gold prices in a downward direction if pursued by a sufficiently large number of the smaller countries, even though it is opposed by a liberal credit policy of the minority.

The return to the gold standard by Great Britain in May, 1925, marks the turning-point in the general restoration of this standard. Comparing wholesale prices then ruling in the United States and Great Britain with those ruling in March, 1928, we get the following picture:—

	U.S.A. (Bureau of Labour).	Great Britain (Board of Trade).	Combined.
May, 1925	154·3	153·6	156.4
March, 1928.....	145·0	140·8	142·9
			—13·6

The combined index (which may be regarded as a tolerably reliable index of the purchasing power of gold) thus shows a fall of 13⅝ points, equivalent to 9 per cent., and it does not seem unreasonable to ascribe this fall in a great measure to the policy of keeping a tight hand on credit practised by the many countries that, during this period, have returned to the gold standard, with a view to maintaining and augmenting their gold reserves.

V.—NEED FOR INVESTIGATION.

The very cursory sketch of the problem that faces the gold standard world given in the preceding pages of this paper seems sufficient to indicate its gravity. The conclusion is irresistible that, if we are to be saved the complex reactions, the economic jolts and setbacks, and the social and political friction which frequent and violent changes in the distribution of national wealth and income through fluctuations in the purchasing power of gold produce—if, in a word, economic progress is not to be seriously impeded, concerted action by the gold standard countries is imperative. If it is impossible to control the supply of monetary gold—and it is manifest that it cannot be controlled—then it is clear that the problem can only be attacked from the side of monetary policy. The Genoa Resolutions recommended the convocation of a conference of central banks. No steps in that direction have as yet been taken, and probably wisely. Before such a conference could hope to do useful work, it was necessary for the great majority of the countries of the civilised world to have returned to the gold standard. That is now on the point of being accomplished. In the meantime, the central banks of the leading gold standard countries have initiated a policy of establishing closer contact one with the other, but it may be doubted whether this contact, or, indeed, a conference of central banks as contemplated by the Genoa Conference, is likely to advance the problem materially without a good deal of preliminary preparation. The problem is a complex one, and its practical solution involves agreement on a number of questions of theory. Nothing could be more detrimental to the smooth, efficient, and expeditious working of a conference of central bankers than the distractions of controversy over fundamentals.

These considerations, coupled with the fact that the problem dealt with in this paper was referred to the Financial Committee on two separate occasions (first by the Brussels Conference and subsequently by the Council, as a result of the Genoa Resolutions), and is still on its agenda, leads me to suggest to my colleagues that it should be fully reconsidered at an early session of the Committee.

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